EXCERPT

GLOBAL INSURANCE INDUSTRY 2021

YEAR IN REVIEW

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Insurance Business Transfers and Corporate Divisions Gather Steam

As has been the trend over the past few years, US jurisdictions have begun adopting legislation allowing solvent insurers (and reinsurers) to restructure blocks of insurance business. These US state laws have their roots in Part VII of the UK's Financial Services and Markets Act of 2000. Since 2000, UK insurers have had the ability to transfer portfolios of in-force insurance policies to other legal entities (commonly referred to as a "**Part VII Transfer**"). While the US based regulators were historically resistant to such legislation, a handful of US jurisdictions have now seen the value in offering insurers more options with respect to management of their in-force business.

Two Types of Restructuring Mechanism

US insurer restructuring legislation comes in two distinct varieties—legislation allowing insurers to engage in an Insurance Business Transfer ("**IBT**") and legislation allowing insurers to undergo a Corporate Division ("**CD**"). IBT transactions are most similar to UK Part VII Transfers in that they allow the insurer to transfer blocks of insurance policies to a different insurer. CD transactions, on the other hand, allow the insurer to divide itself into two or more legal entities, with assets and liabilities (and insurance policies) split among the insurers resulting from the division.

To date, Arkansas, Oklahoma, Rhode Island and Vermont have adopted IBT legislation. The details of the IBT legislation vary among these states, particularly with respect to required approvals for the transaction and which lines of business insurers are authorized to transfer in an IBT transaction. Arkansas and Oklahoma appear to be the most permissive jurisdictions, allowing for the transfer of "all suitable lines" of insurance business. Conversely, Rhode Island and Vermont maintain tighter limitations on which types of business an insurer may transfer—Rhode Island restricts transfers to commercial property and casualty ("**P&C**") business and non-life reinsurance, while Vermont restricts transfers to non-admitted commercial P&C business.

With respect to CD legislation, the states that have adopted CD laws include Arizona, Colorado, Connecticut, Georgia, Illinois, Iowa, Michigan and Pennsylvania. Again, similar to IBT legislation, the details of the legislation, including required approvals, vary among the states. However, given that CD transactions involve the creation of new legal entities to house the insurance business of the dividing insurer, there are very few (if any) limitations on which lines of business can be involved in a CD transaction.

In addition to individual state's interests in restructuring legislation, various interest groups, including the NAIC and the National Council of Insurance Legislators ("**NCOIL**"), are actively engaged in the US's foray into insurer restructuring legislation. As described in our 2020 Year In Review, NCOIL had issued a Model IBT Act closely resembling Oklahoma's IBT legislation, and the NAIC's Financial Condition (E) Committee had established the Restructuring Mechanisms (E) Working Group to evaluate insurer restructuring legislation and to issue a white paper on the subject. Our 2020 Year In Review also reported on the first IBT in the US, which was completed in Oklahoma.

NAIC Restructuring Mechanisms (E) Working Group Adopts White Paper

On October 22, 2021, the NAIC's Restructuring Mechanisms (E) Working Group (the "**Working Group**") published its draft white paper on insurer "Restructuring Mechanisms" (the "**White Paper**"). Though the White Paper makes clear that it is not intended to establish an official position by the NAIC regarding IBTs or CDs, it is a useful platform from which each state and its various regulatory authorities may make their own determinations on how best to proceed with restructuring legislation. To this end, the White Paper identifies a few specific areas of insurance regulation that are implicated by state adoption of IBT or CD legislation, including (1) Guaranty Fund Coverage; (2) Assumption Reinsurance Laws; (3) Long-Term Care Insurance; and (4) Jurisdictional Considerations, each of which is briefly discussed below.

1. Guaranty Fund Coverage

State Guaranty Funds exist to protect policyholders in the event of insurer insolvency. The White Paper raises concerns that "technical gaps may exist" in Guaranty Fund coverage where an insurer finds itself in insolvency following an IBT or CD transaction. The risk of "gaps" in Guaranty Fund coverage are particularly prevalent in those states that have adopted versions of the NAIC's Guaranty Association Model Acts, because certain definitional terms like "Covered Claim," "Member Insurer," "Insolvent Insurer" in the Model Acts were not drafted to capture insurers or policyholder claims that have been impacted by an IBT or CD transaction. To address these concerns, it is expected that the Working Group will approach the NAIC Receivership (E) Task Force for guidance, given the Receivership Task Force's deeper expertise with respect to the Guaranty Association Model Acts.

2. Assumption Reinsurance Laws

Assumption Reinsurance Laws generally provide policyholders with certain notice and consent rights in connection with the novation of their policies to a different insurer. The White Paper expresses concern that a state's adoption of IBT or CD legislation may vitiate these policyholder notice and consent rights, particularly if the IBT or CD legislation is drafted such that insurers are not required to provide notice to policyholders or obtain policyholders' consent in connection with a restructuring transaction. In effect, IBT or CD transactions could be used by insurers, at least in part, to circumvent these policyholder rights. Ultimately, the White Paper concludes that this particular issue is beyond resolution by the Working Group and should be left for courts to determine in the future.

3. Long-Term Care Insurance

The White Paper asserts that Long-Term Care ("**LTC**") coverage is likely not appropriate for restructuring mechanisms. The basis for this position is two-fold. First, given that LTC business has "long-tail liabilities," there is substantial uncertainty with respect to insurer reserve requirements when LTC business is transferred through an IBT or CD transaction. Second, LTC policyholders generally fall into a category of individuals who may find it much more challenging to assert their rights in a court proceeding than a corporate entity. These two concerns, according to the White Paper, make LTC business inappropriate for transfer pursuant to IBT or CD legislation.

4. Jurisdictional Considerations

Given statutory differences among states, the White Paper raises concerns that IBT and CD transactions may not receive recognition or be enforceable in states that have not adopted statutes authorizing such restructuring activity. One likely area of cross-jurisdictional issues is in the context of insurer insolvency. Following an IBT or CD transaction, if the assuming insurer is insolvent and the original insurer is still financially sound, a state court may fail to recognize or enforce the restructuring transaction absence state legislation requiring it to do so, particularly if recognition or enforcement would harm policyholders in that state.

To address such jurisdictional issues, the White Paper supports broad standardization of IBT and CD legislation. On the financial front, the Working Group created its own Restructuring Mechanisms Subgroup to explore best practices pertaining to financial matters such as reserves and capital and long-term liquidity, as well as criteria for monitoring the companies after a restructuring transaction is completed. Beyond the financial aspects, the White Paper supports standardized requirements for all IBT or CD transactions that include court approval for the transaction, use of independent experts to evaluate the restructuring plans, and notice to all affected stakeholders, which would include stakeholders' rights to submit written comments and to attend a public hearing to address the reasonableness of the transaction.

Completion of the First CD Transaction and Approval of the Second IBT

On March 29, 2021, the Illinois Department of Insurance ("**IDOI**") approved the division of eight operating subsidiaries of Allstate Insurance Company ("**Allstate**"). Allstate's "Plans of Division" filed with the IDOI involved, as the initial step, the division of each Illinois-domiciled insurer into a surviving insurer and a new Illinois-domiciled insurer, each holding a portion of the assets, liabilities and contracts of the dividing insurer. The new insurer received certain Michigan automobile insurance policies. In step two of the transaction, the eight new companies merged into three companies pursuant to the Illinois merger statute, so that there was one insurer for each of the Allstate, Esurance and Encompass brands to carry on the Michigan legacy automobile insurance business. As required by the Illinois CD statute, the IDOI held a public hearing at which Allstate corporate officers testified, along with an independent financial expert. The public was also given an opportunity to file comments, questions and objections with the IDOI, but none were filed.

The Allstate CD transaction was complex and dealt with the transfer of automobile insurance, a highly regulated insurance product. As such, insurers, policyholders and state regulators should consider the success of this transaction as a positive step supporting the wider adoption of restructuring mechanisms and potentially also ameliorating skepticism regarding the practicality of restructuring activities.

Turning to IBT transactions, the second US IBT was approved on August 26, 2021. Like the first IBT, the second IBT was approved in Oklahoma and involved the transfer of Excess Casualty Reinsurance Association ("**ECRA**") pooled assumed reinsurance written by Sentry Insurance Company ("**SIC**"), a Wisconsin-domiciled insurer, to National Legacy Insurance Company ("**NLIC**"), an Oklahoma domiciled subsidiary of Randall & Quilter Investment Holdings, Ltd. SIC transferred its current and future ECRA assumed reinsurance liabilities, obligations and continued expenses to NLIC for approximately $2.9 million. An important aspect of the Oklahoma regulator's approval of the transfer was that the transfer would not affect the policy terms, or negatively impact policy administration or other rights and obligations arising under the pooled business.

Oklahoma's second IBT also highlights the value of restructuring activities. Though SIC's portion of the total ECRA reinsurance liabilities was small, ranging from 0.369% to 0.593%, depending on policy year, the transfer of the business presented the opportunity for SIC to hand off the business to an entity which was, among other things, better suited to handle administration of the policies.

UK Improvements to Part VII Transfer Process

As mentioned in the introductory section, Part VII of the UK's Financial Services and Markets Act of 2000 enables UK insurers to transfer blocks of business to other legal entities. By some estimates, there have been over 300 Part VII Transfers completed in the UK to date. In addition to the requirements found in the Part VII Transfer laws, UK insurers are guided in their restructuring activities by the UK's Prudential Regulatory Authority ("**PRA**") and Financial Conduct Authority ("**FCA**"). These regulatory bodies publish guidance setting forth the criteria insurers must meet when undertaking a Part VII Transfer (PRA's Part VII guidance is referred to as the "**PRA Statement of Policy**" and FCA's guidance is referred to as "**FCA Finalised Guidance**").

The PRA Statement of Policy and the FCA Finalised Guidance function as somewhat of a roadmap to guide UK insurers as they navigate a Part VII Transfer. In July of 2021, both PRA and FCA published proposed revisions and solicited comments to their respective guidance materials, ostensibly necessitated by Brexit (PRA's revisions are accessible here, and FCA's are available here). Both PRA's and FCA's revisions are geared towards process improvements that increase protections for all stakeholders involved in a Part VII Transfer. As of January 2022, PRA adopted its revisions into its 2022 Statement of Policy, while FCA is still processing its revisions and has not yet promulgated a revised FCA Finalised Guidance.

Specifically, PRA's revisions to its Statement of Policy center around increased requirements for transferor insurers with respect to risk mitigation strategies, and impose new requirements on "independent experts" when evaluating the transactional risk of the transfer. The PRA Statement of Policy revisions also increase the standards for evaluating insurers' "operational readiness" to undertake a Part VII Transfer when seeking to restructure non-life run-off business.

FCA's proposed revisions, though not yet adopted into the FCA Finalised Guidance, make clear that a transferor insurer must work closely with FCA throughout the Part VII Transfer process, including bringing transaction related issues to FCA's attention proactively and in "good time." Key aspects of FCA's recent revisions also include requiring the transferor and transferee insurers to synchronize claims management philosophies to prevent any potential negative impact to policyholders, as well as requiring the transferor insurer to show it has adequately responded to any policyholder objections to the proposed transfer. Finally, FCA's revisions recognize the importance and utility of technology in the transfer process and, as such, greenlight insurers' use of electronic methods for providing notice and other communications to policyholders impacted by the Part VII Transfer.

In sum, the Part VII Transfer laws, and the guidance promulgated in connection therewith, set the standard for insurer restructuring across the global. The recent refinements to UK's already successful restructuring process may place added pressures on US regulators to chart a path forward for wider adoption of IBT and CD legislation by the individual states—the more functional the UK process, the more industry groups, insurers and US regulators can feel comfortable that restructuring laws present a substantial benefit to all stakeholders involved.

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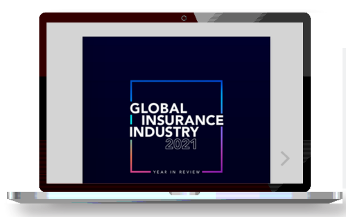

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